

STATE OF IOWA  
DEPARTMENT OF COMMERCE  
UTILITIES BOARD

IN RE:  AQUILA, INC., d/b/a AQUILA NETWORKS	DOCKET NO. RPU-02-5
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**ORDER SETTING TEMPORARY RATES AND  
APPROVING CORPORATE UNDERTAKING**

(Issued August 28, 2002)

On June 3, 2002, Aquila, Inc., d/b/a Aquila Networks (Aquila), filed with the Utilities Board (Board) proposed tariffs, identified as TF-02-238 and TF-02-239. In TF-02-238, Aquila is proposing a temporary rate increase that would produce additional revenue of approximately \$8.1 million. In TF-02-239, Aquila is proposing a permanent annual revenue increase of approximately \$9.3 million, or an overall annual revenue increase of 5.8 percent. The Board docketed the proposed temporary and permanent rate increases as Docket No. RPU-02-5.

On July 2, 2002, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed an objection to the request for temporary rates. On July 5, 2002, the Board issued an order requesting additional information from Aquila concerning the allocation of labor expense reductions due to recent employee layoffs at Aquila. Aquila filed its reply to Consumer Advocate's objection and its response to the Board's request for additional information on July 15, 2002.

On July 23, 2002, Aquila and Consumer Advocate filed a joint motion requesting the Board establish an annual revenue requirement for temporary rates without consideration of complete information regarding workforce reductions, then reduce that revenue requirement by \$211,959.00 to reflect savings and costs associated with Aquila Networks' workforce reductions. Aquila Networks is still in the process of altering its workforce.

Iowa Code § 476.6(13) (2001) controls the manner in which the Board sets temporary rates. That statute provides, in part:

Upon the request of a public utility, the board shall, when required by this subsection, grant the public utility temporary authority to place in effect any or all of the suspended rates, charges, schedules or regulations by filing with the board a bond or other undertaking approved by the board conditioned upon the refund in a manner to be prescribed by the board of any amounts collected in excess of the amounts which would have been collected under rates, charges, schedules or regulations finally approved by the board. In determining the portion of the new or changed rates, charges, schedules or regulations to be placed in effect prior to a final decision, the board shall apply previously established regulatory principles and shall, at a minimum, permit rates and charges which will allow the utility the opportunity to earn a return on common stock equity equal to that which the board held reasonable and just in the most recent rate case involving the same utility or the same type of utility service, provided that if the most recent final decision of the board in an applicable rate case was rendered more than twelve months prior to the date of filing of the request for temporary rates, the board shall in addition consider financial market data that is filed or that is otherwise available to the board and shall adjust the rate of return on common stock equity that was approved in that decision upward or downward as necessary to reflect current conditions.

In Northwestern Bell v. Iowa State Commerce Commission, 359 N.W.2d 491, 496

(Iowa 1984), the Iowa Supreme Court interpreted this statute and stated, in part:

[I]n the 1983 Code the Assembly telescoped the temporary and permanent rate steps into one procedure, evidently to end the prior problem of a utility's placing its new rates in effect in temporary form under bond and then having little motivation to press forward with the permanent rate aspect. The General Assembly has ended the ability of the utility itself to set the temporary rates in the usual situation; the commission sets them and proceeds to the permanent rates. If instead the utility could obtain judicial review of temporary rates and obtain its desired rates from the courts, as in this case, its motivation to seek permanent rates would be dulled and fulfillment of the legislative scheme would be hampered. To minimize the possibility of harm to the utilities, the legislature started time running from the original filing as to both temporary and permanent rates ...

While permanent rates may ultimately be set higher than the commission's temporary rates, by shortening the time for the commission's final decision to ten months and by streamlining the temporary and permanent rate procedure, the Assembly has demonstrated its desire to minimize utility hardship.

The Board, therefore, is directed to permit Aquila to collect rates which, at a minimum, allow the return on common equity equal to that which was held reasonable in the most recent rate case involving the same utility or same type of utility service, provided the Board's decision was rendered within 12 months prior to Aquila's request for temporary rates. If there is not a Board decision within the prior 12 months, the Board shall consider market data that is filed or that is otherwise available to adjust the most recent return on common equity to reflect current conditions.

In addition, the Board is directed to apply established regulatory principles in setting the return on common equity and considering any proposed adjustments. Since the legislature directs the Board to establish a temporary rate level by applying established regulatory principles rather than examining an evidentiary record, it is not appropriate for the Board to make detailed findings of fact on each individual issue.

Consumer Advocate's objection to Aquila's request for temporary rates, Aquila's reply to the objection, and the parties' joint motion to the Board have narrowed the issues to be considered in setting temporary rates. The issues to be addressed will be discussed below.

## **I. COST OF CAPITAL**

### **A. Return on Common Equity**

In determining the appropriate return on common equity to use in setting temporary rates for Aquila, the Board must apply the requirements of Iowa Code § 476.6(13) set out above. As there has not been a litigated gas case within the past 12 months, the Board has considered filed market data and other current available data to determine a reasonable return on common equity for Aquila.

In this case, Aquila proposes a 12 percent return on common equity which is supported by current financial data and analysis presented by its witness, John C. Dunn. Witness Dunn provides a discounted cash flow (DCF) model analysis to reach this figure, using an adjusted dividend yield of 5 percent and a growth rate of 7 percent to reach a 12 percent estimate for cost of equity.

Aquila states in its response to Consumer Advocate's objection that a minimum acceptable return on common equity would be 11.3 percent as that is the amount recently allowed to MidAmerican Energy Company for temporary rates in its current gas case before the Board identified as Docket No. RPU-02-2.

Consumer Advocate proposes a return on common equity of 11.02 percent. This return on common equity is calculated using the May A-rated public utility bond yield of 7.52 percent and the midpoint of the risk premium range of 250 – 450 basis points. Consumer Advocate suggests that this figure should be a maximum since the yield on A-rated utility bonds has since fallen.

The Board has used a risk premium methodology in recent decisions to establish a return on common equity for temporary rates. The Board finds that this is the established regulatory principle to utilize in this case. The methodology has consisted of adding a risk premium range to the most recent market yield for A-rated utility bonds. Although different risk premium ranges have been approved by the Board, the Board finds that the risk premium range of 250 – 450 basis points should be used in setting temporary rates for Aquila.

The most current A-rated utility bond yield available to the Board is 7.52 percent for May 2002, found in the "Mergent Bond Record," June 2002, Vol. 69, No. 6. Using the Board's usual risk premium range of 250 – 450 basis points yields a range of reasonable return from 10.02 to 12.02 percent. After considering all current market data and the most recent available information, the Board finds the return for temporary rates should be set slightly above the mid-point of the risk premium range.

The Board found that an 11.3 percent return on equity was reasonable in Docket No. RPU-02-2, and although this does not establish a legal precedent, it does reflect recent market conditions. The Board finds market conditions have not changed significantly since Docket No. RPU-02-2, and will adopt an 11.3 percent return on equity for Aquila's temporary rates.

**B. Capital Structure**

Aquila proposes the Board use the 13-month average capital structure on the books and records of the Aquila Networks division of Aquila, Inc., to establish temporary rates. This capitalization is 50.4159 percent equity and 49.5841 percent debt, with a debt rate of 7.7603 percent. Aquila's witness John C. Dunn states that Aquila Networks is a division of Aquila, Inc., from which it receives all of its capital. Witness Dunn argues that this allocated capital structure is more appropriate than the consolidated capital structure of Aquila, Inc., which also funds non-regulated and international operations.

Consumer Advocate proposes the Board use the 13-month average capital structure of Aquila, Inc., establishing temporary rates. This capitalization is 45.482 percent equity and 54.518 percent debt, with a debt rate of 6.382 percent. Consumer Advocate asserts that Aquila's proposed allocation is inappropriate, as it does not reflect the actual financing of Aquila Networks' Iowa operations, the risks of those operations, or the fungibility of capital. Consumer Advocate states that Aquila, Inc.'s capital structure is the only capital structure that actually supports Aquila, Inc.'s

investments in its various operations, including its regulated natural gas operations in Iowa.

The Board's established precedent in determining capital structure is to adopt the actual capital structure of the combination utility rather than the separate division. The Board finds that additional evidentiary findings are needed regarding the basis for allocations made to the regulated entity before the Board could adopt the capital structure as proposed by Aquila. Based upon established regulatory principles, the Board will adopt the capital structure proposed by the Consumer Advocate.

## **II. REVENUE REQUIREMENT REDUCTION**

On July 23, 2002, Consumer Advocate and Aquila Networks filed a joint motion with the Board requesting the Board establish an annual revenue requirement for temporary rates without consideration of complete information regarding workforce reductions and then reduce that revenue requirement by \$211,959.00. This figure is the amount agreed upon by the parties to reflect savings and costs associated with Aquila Networks' workforce reductions.

The Board finds that the revenue requirement reduction is reasonable and will approve the parties' joint motion to utilize the above described procedure to establish a revenue requirement for temporary rates in this proceeding.

## **III. CORPORATE UNDERTAKING**

In conjunction with the application for temporary rates, Aquila filed a corporate undertaking in which it agreed to refund any temporary rates up to \$8,099,764, with

interest, which are collected that exceed final rates ultimately approved by the Board. The Board finds that this corporate undertaking is sufficient to ensure payment of any required refund and will be approved.

#### **IV. ORDERING CLAUSES**

##### **IT IS THEREFORE ORDERED:**

1. Temporary rates based on this order shall become effective as of the date of this order, pursuant to Iowa Code § 476.6(13) (2001).
2. On or before 20 days from the date of this order, Aquila, Inc., d/b/a Aquila Networks, shall file revised tariff sheets that produce total revenue, including a temporary rate increase of \$5,653,372, not to exceed \$171,169,182. Attached to this order, and incorporated by reference, are schedules A through D reflecting a total revenue requirement, rate base, rate of return, and income statement.
3. The corporate undertaking of Aquila, Inc., d/b/a Aquila Networks is approved.

#### **UTILITIES BOARD**

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper  
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 28<sup>th</sup> day of August, 2002.



Aquila Inc.  
d/b/a Aquila Networks - PNG  
Revenue Requirement  
Docket No. RPU-02-5  
Temporary Rates

Schedule A

Line No.	Description (A)	Amount (B)
1	Rate Base	\$68,240,736
2	Rate of Return	8.619%
3	Required Net Operating Income	\$5,881,549
4	Adjusted Net Operating Income	\$2,454,437
5	Net Operating Income Deficiency (Excess)	\$3,427,112
6	Additional Income Taxes - Federal at (31.46%)	\$1,845,244
7	State at (10.11%)	\$592,975
8	Revenue Deficiency (Excess)	\$5,865,331
9	Adjusted Operating Revenue	\$165,515,810
10	Revenue Requirement before Joint Motion Adjustment	\$171,381,141
11	Joint Motion to Reduce Revenue Requirement	(\$211,959)
12	Revenue Requirement	\$171,169,182

Aquila Inc.  
d/b/a Aquila Networks - PNG  
Adjusted Rate Base  
Docket No. RPU-02-5  
Temporary Rates

Schedule B

Line No.	Description (A)	Adjusted Amounts (D)
1	Plant in Service	\$161,738,017
2	Accumulated Amort. & Deprec.	\$90,195,394
3	Net Utility Plant	<u>\$71,542,623</u>
<b>Additions:</b>		
4	Materials and Supplies	\$1,086,343
5	Fuel Stocks	\$6,109,026
6	Prepayments	\$1,214,981
7	Cash Working Capital	\$670,214
8	Total Additions	<u>\$9,080,564</u>
<b>Deductions:</b>		
9	Accum. Deferred Income Tax	\$11,158,928
10	Customer Advances	\$81,246
11	Customer Deposits	\$408,940
12	Accum. Prov. For Uncollectibles	\$601,573
13	Accrued Vacation	\$61,465
14	Reserves	\$70,299
15	Total Deductions	<u>\$12,382,451</u>
16	Total Rate Base	<u><u>\$68,240,736</u></u>

Aquila Inc.  
d/b/a Aquila Networks - PNG  
Rate of Return  
Docket No. RPU-02-5  
Temporary Rates

Schedule C

Line No.	Description (A)	Amount (B)	Ratio (C)	Cost Rate (D)	Weighted Cost (E)
1	Long-term Debt	\$2,858,121,000	54.518%	6.382%	3.479%
2	Common Equity	<u>\$2,384,444,000</u>	<u>45.482%</u>	11.300%	<u>5.140%</u>
3	Total	<u><u>\$5,242,565,000</u></u>	<u><u>100.000%</u></u>		<u><u>8.619%</u></u>

Aquila Inc.  
d/b/a Aquila Networks - PNG  
Adjusted Income Statement  
Docket No. RPU-02-5  
Temporary Rates

Schedule D

Line No.	Description (A)	Adjusted Amounts (B)
1	<b>Operating Revenues</b>	\$171,381,141
2	<b>Operating Expenses</b>	
3	Purchase Gas	\$126,140,127
4	Other O & M Expenses	\$27,539,150
5	Depreciation and Amortization	\$6,624,362
6	Taxes Other Than Income	\$3,260,771
7	Federal Income Tax	\$2,076,430
8	State Income Tax	\$667,280
9	Deferred Income Tax	(\$808,528)
10	Total Operating Expense	<u>\$165,499,591</u>
11	Operating Income	<u><u>\$5,881,550</u></u>